Factsheet — Financial Climate Risk Regulation
The European Union

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PERSPECTIVE

Regulation on climate risk in Europe is likely to have a rippling effect across markets globally. Since establishing the High-Level Expert Group on Sustainable Finance (HLEG) in 2016, the European Union (EU) has positioned itself as a leader in sustainable finance. It has made rapid progress on integrating climate change into its financial sector, simultaneously addressing it from several angles, including risk disclosure, green bond labels, a taxonomy for adaptation and mitigation, and risk management oversight directives. While still a work in progress, the Sustainable Finance Taxonomy will help build consistency in accounting for investments, and the non-binding guidelines for incorporating climate risk into the non-financial reporting directive will help bring consistency to firms' disclosures. As global financial actors operate, and are regulated, in Europe, EU regulations are likely to propel a development in best practices for addressing climate risk that reaches beyond the EU. Likewise, regulators and financial actors across the world are watching carefully as EU regulation may influence their own action.

STANCE

Since 2016, the EU has been a consistent and vocal force for integrating climate change into financial markets in the EU and beyond. In November 2016, the EU passed a law mandating pension funds to consider ESG risks, including climate change, in their investment strategies. This was a meaningful first step in what has become a comprehensive effort to address climate risks and build a resilient and sustainable European financial system.

The European Commission (EC) established the HLEG in December 2016 to develop recommendations to reform the financial system to promote sustainable investments, address risks, and also build resilience in the financial system itself. In January 2018, this group of experts from banking, insurance, asset management, stock exchanges, and other financial institutions released their final recommendations to the European Commission, stating that "the HLEG hopes to stimulate a wide public debate that helps shift Europe's financial system from post-crisis stabilization to supporting long-term growth." From here, the EC built its Action Plan, outlining ten specific actions to be pursued simultaneously with deadlines by the end of 2019, emphasizing that a "coordinated, global effort is crucial." The EC continues to make progress on its ambitious goals, beginning by developing the Technical Expert Group on Sustainable Finance (TEG), which has released consultations and reports on climate risk disclosure, a sustainable finance taxonomy, green bond standards, and sustainability benchmarks. Meanwhile, it has engaged the European Supervisory Authorities around integrating sustainability and climate into oversight requirements.

The European Central Bank (ECB) has also taken a stance on the financial risks of climate change. In November 2018, Benoît Cœuré, of the ECB's Executive Board, emphasized the potential impacts of climate change on monetary policy. He explained that the ECB plans to "concentrate its efforts on supporting market participants, legislators and standard-setting bodies in identifying the risks emerging from climate change and providing a clear framework to reorient financial flows and reduce such risks."

INTEGRATING CLIMATE RISKS INTO THE NONBINDING GUIDELINES FOR NON-FINANCIAL REPORTING

Guidelines on Reporting Climate-related Information —The EC published new Nonbinding Guidelines (NBGs) for incorporating climate risk into the non-financial reporting directive (NFRD) (Directive 2014/95/EU) in June 2019. The new guidelines map to the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations and also include key recommendations from Advancing TCFD Guidance for Physical Risks and Opportunities, a European Bank of Reconstruction and Development and GCECA report on disclosing physical climate risks. Recommendations include disclosing locations critical to the value chain, the potential financial impact of extreme weather events, and any adaptation efforts by the company. The NFRD applies to public entities with over 500 employees, including listed corporations, banks, and insurers. It mandates the disclosure of non-financial information such as environmental, social, human rights, corruption, and diversity factors. The NBGs help companies disclose non-financial risks in clear and comparable ways. While they are not mandatory, they inform about 6,000 companies that are mandated to report under the NFRD. These final guidelines are based on public consultations of draft reports from both the Technical Expert Group on Sustainable Finance and the European Commission.

SUSTAINABLE FINANCE TAXONOMY

Sustainable Finance Taxonomy—The EU released the Technical Expert Group (TEG) report on a taxonomy for activities that contribute to climate adaptation and mitigation in June 2019. The taxonomy aims to help investors and policymakers understand which economic activities contribute to the transition to a low-carbon economy, through both mitigation and resilience. It outlines qualitative screening criteria to identify adaptation of economic activities and adaptation by economic activities, providing activity-specific examples for a range of sectors. It is meant to be dynamic and to develop alongside scientific and technological research.

The TEG is accepting public feedback on the Taxonomy **through September 13, 2019**, which it will consider when advising the EC on next steps. After the Council of the EU and the European Parliament agree on the Taxonomy, there will be delegated acts developed from the report followed by a formal consultation on these acts.

MANDATING DISCLOSURE OF ESG INTEGRATION IN RISK MANAGEMENT

Position of the European Parliament and Council for Updating IORP II —In April 2019, the European Parliament and Council agreed on text for regulation on disclosures relating to sustainability risks and investments and for amending Directive EU 2016/2341 (IORP II) related to activities and supervision of institutions for occupational retirement provision. This explicitly states that climate change demands urgent action. It calls for financial sector participants to disclose their strategy for responding to their sustainability risks as well as their own adverse sustainability impacts. It defines sustainable investments as "investments in economic activities that contribute to environmental or social objectives as well their combination, provided that the invested companies follow good governance practices and the precautionary principle of 'do no significant harm' is ensured." This legislation lays the groundwork for ongoing updates to integrate sustainability into other supervisory directives. The primary goal of these efforts is to improve disclosures to investors and improve their protections. In early July 2019, EIOPA released its draft opinion on integrating ESG into IORP II, explicitly calling for more quantitative assessment of climate risk exposure by retirement pensions, including through scenario analysis.

AMENDING DELEGATED ACTS TO INCORPORATE SUSTAINABILITY

In July 2018, the EC formally requested that EIOPA and ESMA provide technical advice on proposed changes to the below directives regarding how the financial sector integrates sustainability into its risk management, operations, investment strategies, and governance.

European Securities and Markets Authority (ESMA)	European Insurance and Occupational Pensions Authority (EIOPA)
Directive 2009/65/EC (UCITS Directive) – rule relating to undertakings for collective investment in transferable securities	Directive 2009/138/EC (Solvency II Directive) – on the business of insurance and reinsurance
Directive 2011/61/EU (AIFMD) – framework for managers of alternative investment funds such as hedge funds and private equity	Directive 2016/97 (IDD) – framework to improve how insurance products are sold
Directive 2014/65/EU (MiFID II) – framework for improving the transparency of EU financial markets	

European Insurance and Occupational Pensions Authority (EIOPA) consultation—In April 2019, EIOPA released its final report of technical advice to the EC on integrating sustainability factors into the organizational requirements, operating conditions, and risk management of Solvency II and the organizational requirements and product oversight and governance elements of IDD. The report integrated feedback from a public consultation. It suggests that sustainability risks be explicitly added to directive language and also explicitly includes climate risks in the risk management section of Solvency II. EIOPA emphasizes that while some sustainability risks may be emerging, many are already affecting assets, and thus sustainability should not be considered an emerging risk. While Solvency II provisions on governance already mandate the consideration of all risks, which includes sustainability, EIOPA acknowledges the value of explicitly calling out sustainability. EIOPA also emphasizes the need for allowing flexibility for firms to tailor their approach as appropriate for these activities, but also the importance of explicitly requiring that firms manage sustainability risks. EIOPA acknowledges the need for proportionality in implementation requirements given different sizes, activities, and resources of firms.

European Securities and Markets Authority (ESMA) consultation —In April 2019, ESMA released its final reports with technical advice for the EC's integration of sustainability considerations into MiFD II and into UCITS Directive and AIFMD, including responses to feedback received during a public consultation. This advice relates to how investment firms and insurers consider ESG factors when advising their clients. ESMA's high-level and principles-based approach was supported by respondents who emphasized the importance of allowing flexibility for firms to adopt the requirements in a way that is reasonable for their size and goals. ESMA recommends that "sustainability" and "ESG" are added throughout the directives. While several respondents urged ESMA to more explicitly define "sustainability," ESMA notes that providing rigid definitions that are not applicable across industries would not be beneficial and cites the Disclosure Regulation (EU 2016/2341) as an important reference. These directives also consider proportionality, aiming to avoid undue burden on firms that are small or limited in resources. The MiFID II updates will go through a 3-6 month period in the European Parliament and Council, followed by a 12-month delay before coming into force. ESMA suggests that the timing for the UCITS Directive and AIFMD align with that of the Disclosure Regulation.

European Banking Authority (EBA) Assessment— In February 2019, the EC and the Parliament's Committee on Economic and Monetary Affairs determined that the EBA will spend two years assessing definitions for ESG risks, criteria for assessing their impacts on financial stability, and the strategies banks currently use to address these risks. The EBA's assessment will be used to develop a draft amendment requiring "large institutions" to disclose their risk and the disclosures will be required three years after the regulation is implemented.

Four Twenty Seven

ABOUT FOUR TWENTY SEVEN

Four Twenty Seven (427mt.com) is the leading provider of market intelligence on the impacts of climate change for financial markets. We tackle physical risk head on by identifying the locations of corporate production and retail sites around the world and their exposure to climate change hazards such as sea level rise, droughts, floods and tropical storms, which pose an immediate threat to investment portfolios.

Four Twenty Seven's ever-growing database now includes one million corporate sites and covers over 2000 publicly-traded companies. We offer subscription products and professional services to access this unique dataset. Options include data licenses, an interactive analytics platform, and company scorecards, as well as reporting services, scenario analysis, and real asset portfolio risk assessments.

Four Twenty Seven has won multiple awards for its innovative work on climate risk and resilience and our work has been featured by Bloomberg, the Financial Times and the UNFCCC. Four Twenty Seven was founded in 2012 and is headquartered in Berkeley, California with offices in Washington, DC and Paris, France.

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